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# Federal Regulation of Natural Gas Companies-- The East Ohio Gas Case

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# WESTERN RESERVE LAW REVIEW

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## NOTES

### *Federal Regulation of Natural Gas Companies—The East Ohio Gas Case*

THE GROWTH and development of the natural gas industry has been a business phenomenon of the past seventy years.<sup>1</sup> This development was accompanied by business practices which resulted in excessive prices charged to local consumers.<sup>2</sup> Individual states, attempting to protect the local consumer, found themselves constitutionally unable to control some natural gas transactions directly affecting local prices.<sup>3</sup> In 1938, Congress,

<sup>1</sup> Fortune, Dec., 1949, p. 107.

<sup>2</sup> SCHUMAN, THE PETROLEUM INDUSTRY 240 (1940): "The Federal Trade Commission concluded in 1934 that fifteen holding company groups controlled over 80 per cent of all the natural-gas trunk pipe lines of the United States." Included in sixteen specific evils found existent in the gas industry was that of excessive profits in many natural gas sales between affiliates.

<sup>3</sup> Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Co., 273 U.S. 83, 47 Sup. Ct. 294 (1927); Missouri *ex rel.* Barrett v. Kansas Natural Gas Co., 265 U.S. 298, 44 Sup. Ct. 544 (1924).

to provide effective regulation of the industry, bestowed regulatory power upon the Federal Power Commission by enacting the Natural Gas Act.<sup>4</sup> Section 1 (b) of that Act states:

The provision of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

The exercise of jurisdiction by the Federal Power Commission under this section of the Natural Gas Act has been the subject of extensive controversy, culminating in the recent Supreme Court decision in *Federal Power Commission v. East Ohio Gas Co.*<sup>5</sup> The East Ohio Gas Co. is engaged in the business of distributing natural gas solely to Ohio consumers. It purchases the gas within Ohio's boundaries from interstate natural gas companies, transports it, without reduction in pressure, in its own high pressure trunk lines to the various city gates, then mechanically reduces the pressure for entrance into local mains and transmission to consumers. The FPC ordered East Ohio to prepare and submit financial and statistical reports in accordance with the Commission's uniform accounting system, on the ground that East Ohio was subject to FPC control under the Natural Gas Act.<sup>6</sup> The orders were reversed by the Court of Appeals for the District of Columbia,<sup>7</sup> but this judgment was upset by the Supreme Court in a split decision.<sup>8</sup> East Ohio was engaged in the "transportation<sup>9</sup> of natural gas in interstate commerce" within the meaning of the Act, said the Court, since gas transported in its high pressure trunk lines was in interstate commerce, and those high pressure trunk lines were not facilities used in local distribution and hence were not exempted by the Act from federal regulation. The Court conceded that Congress intended to grant to the FPC regulatory power only over those transactions which the states lacked power to regulate. The Court, however, declared that in its decisions prior to the adoption of the Act the limits of state regulatory power had been de-

<sup>4</sup> 52 STAT. 821, 15 U.S.C. § 717 (1938), as amended 56 STAT. 83 (1942), 15 U.S.C. § 717 (Supp. 1949).

<sup>5</sup> 70 Sup. Ct. 266, *rehearing denied mem.*, 70 Sup. Ct. 515 (1950).

<sup>6</sup> *East Ohio Gas Co.*, 74 P. U. R. (N.S.) 256 (1947).

<sup>7</sup> *East Ohio Gas Co. v. Federal Power Commission*, 173 F.2d 429 (D.C. Cir. 1949).

<sup>8</sup> Mr. Justice Black wrote the majority opinion. Mr. Justice Jackson dissented with Mr. Justice Frankfurter concurring. Mr. Justice Burton and Mr. Justice Douglas took no part in the decision.

<sup>9</sup> The Court summarily dismissed the contention that the words "transportation of natural gas" of section 1 (b) were intended to mean only the "business" of transporting gas, 70 Sup. Ct. at 268.

terminated by the mechanistic test that states could regulate gas coming into the state from interstate commerce only after the gas had been reduced in pressure and entered a local distribution system. The Court reasoned that Congress, in enacting the Natural Gas Act, had intended that this test should define the limits of the FPC's power to control—whatever the Court might now consider the limits of the states' regulatory powers.

Two justices<sup>10</sup> dissented, contending that Congress did not manifest an intention to incorporate into the Act as a measure of the FPC's area of control the test used by the Court at the time of adoption of the Act for setting the limits of state regulatory powers, but that even assuming such an intention, the mechanistic test referred to by the majority of the Court was not the prevailing test at the time the Act was passed, and so Congress could not have intended to adopt that particular method to determine the point at which federal regulatory power should begin.

The legislative history of the Natural Gas Act clearly establishes that the broad purpose of the Act was to provide federal regulation only for that area of the industry which the states had no constitutional power to regulate.<sup>11</sup> It was the purpose of the Act not to extend federal regulation to its constitutional limits, but rather to complement state regulation. It is difficult to determine whether Congress intended to cast the Act "in the mold made by prior decisions" defining the limits of state regulatory power, as contended by the majority in the principal case.<sup>12</sup> However, the theory of the majority opinion that the mechanistic formula to which it referred was conceived by Congress to be the prevailing test of state power, and was intended by Congress to determine the extent of the FPC's area of control, is considerably weakened by the fact that the jurisdictional clause of the original draft of the Act<sup>13</sup> expressly gave to the FPC jurisdiction over natural gas companies transporting gas in interstate commerce in high pressure lines, while the jurisdictional clause of the Act as finally adopted contained no such reference to the pressure at which gas is transported.<sup>14</sup>

<sup>10</sup> Jackson and Frankfurter.

<sup>11</sup> H.R. REP. No. 2651, 74th Cong., 2d Sess. 1 (1936); SEN. REP. No. 1162, 75th Cong., 1st Sess. 2 (1937). See 81 CONG. REC. 9312 *et seq.* (1937).

<sup>12</sup> 70 Sup. Ct. at 275.

<sup>13</sup> H.R. 11662, 74th Cong., 2d Sess. § 1(b) (1936).

<sup>14</sup> The committee considering the bill discussed the following cases: *East Ohio Gas Co. v. Tax Commission*, 283 U.S. 465, 51 Sup. Ct. 499 (1931); *Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Co.*, 273 U.S. 83, 47 Sup. Ct. 294 (1927); *Missouri ex rel. Barrett v. Kansas Natural Gas Co.*, 265 U.S. 298, 44 Sup. Ct. 544 (1924); *Pennsylvania Gas Co. v. Public Service Commission*, 252 U.S. 23, 40 Sup. Ct. 279 (1920); *Public Utilities Commission v. Landon*, 249 U.S. 236, 39 Sup. Ct. 268 (1919). *Hearings Before Committee on Interstate and Foreign Commerce on H.R. 11662*, 74th Cong., 2d Sess. 14 (1936). The majority opinion in the principal case declared that this fact evidenced Congress' intention to

If it be assumed that Congress intended to provide federal regulatory power up to the point at which the Supreme Court had previously declared state power ended, it is necessary to examine the decisions of the Supreme Court which defined the limitations of state power prior to adoption of the Natural Gas Act. The first case considering the problem of a state's power to regulate rates charged to consumers for the purchase of gas which had been transported in interstate commerce was *Public Utilities Commission v. Landon*,<sup>15</sup> decided in 1919. A gas-producing company piped gas into Kansas from outside the state and sold the gas in Kansas to a distributing company which resold to consumers. The Kansas commission regulated the price charged by the distributing company to consumers. The producing company attacked this price regulation on the ground that it affected that company's interstate business since the price paid by the distributing company to it was a percentage of the price charged to consumers by the distributing company. The Court, however, held the regulation valid because interstate commerce ceased when the gas passed into the mains of local companies having authority to resell. The pressure at which the gas was transported at any particular stage was not made the ground for the court's determination of when state power began. The following year *Pennsylvania Gas Co. v. Public Service Commission*<sup>16</sup> was decided. In that case a Pennsylvania company transported gas from Pennsylvania into New York and sold directly to New York consumers. The New York commission ordered the company to reduce rates charged to New York consumers. In upholding the regulation the Court held that the transmission from the Pennsylvania well to the New York consumer constituted interstate commerce until the gas reached the consumer's burner tips, but that the furnishing of gas to the consumer was local in character under the doctrine of *Cooley v. The Board of Wardens of the Port of Philadelphia*,<sup>17</sup> and therefore could be regulated by the state in which it occurred until Congress subjected the transaction to its own regulation.

In both the *Landon* and *Pennsylvania Gas* cases, the power of the state to regulate the retail sale to local consumers was upheld, although upon different theories. In 1924, however, the court in *Missouri ex rel. Barrett v.*

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adopt the mechanistic formula. However, many statements in the committee reports indicate that the significance attached to these cases by the committee was not clear. See *Hearings, supra* at 72, 91. The lack of definiteness in the terms employed in § 1(b) led to later proposals to redefine these terms. *Hearings before Committee on Interstate and Foreign Commerce on H.R. 2185, H.R. 2235, H.R. 2292, H.R. 2569, and H.R. 2956, 80th Cong., 1st Sess. (1947).*

<sup>15</sup> 249 U.S. 236, 39 Sup. Ct. 268.

<sup>16</sup> 252 U.S. 23, 40 Sup. Ct. 279 (1920).

<sup>17</sup> 12 How. 299 (U.S. 1851).

*Kansas Natural Gas Co.*<sup>18</sup> created an area into which state regulatory power could not extend. Missouri had attempted to fix the price charged by a carrying company which transported gas from outside Missouri into the state and sold to Missouri distributing companies for resale to Missouri consumers. The price-fixing was held invalid, on the ground that the transmission and sale for resale constituted interstate commerce, and a state enactment imposing a direct burden on interstate commerce must fall even though Congress has not seen fit to regulate that particular part of interstate commerce. However, the Court stated that interstate commerce ended with the delivery of the gas to the distributing company, and the subsequent sale by the distributing company to consumers was a sale in intrastate commerce and subject to state regulation.<sup>19</sup>

The mechanistic test made its first appearance in 1931, in the case of *East Ohio Gas Co. v. Tax Commission*.<sup>20</sup> East Ohio bought gas at the state lines and transported it in high pressure pipelines to local mains where pressure was reduced for sale to local consumers. The Court, declaring that the transmission of the gas from the out-of-state wells to the local mains was interstate commerce, but that this interstate commerce ended upon entrance of the gas into the local mains, held valid an Ohio excise tax measured by gross receipt from sales by East Ohio to local consumers. The Court likened the reduction of pressure at the point of entrance to the local mains to the "breaking of an original package, after shipment in interstate commerce, in order that its contents may be treated, prepared for sale and sold at retail."<sup>21</sup> The *Pennsylvania Gas* case was expressly disapproved to the extent that it held that interstate commerce continued until the gas is delivered to the consumer's burner tips.

Within one year the Court rejected the mechanistic test in another tax case. In *State Tax Commission v. Interstate Natural Gas Co.*<sup>22</sup> Mississippi

<sup>18</sup> 265 U.S. 298, 44 Sup. Ct. 544.

<sup>19</sup> The *Kansas Natural Gas* case and *Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Co.*, 273 U.S. 83, 47 Sup. Ct. 294 (1927), taken together, created a "gap" in the natural gas industry between the processes of production and consumption from which state regulatory power was excluded. The *Attleboro* case, although involving regulation of electricity, has been uniformly considered to apply to and limit state power over natural gas companies. In that case Rhode Island was denied power to regulate the price charged to a Massachusetts distributing company for electricity generated in Rhode Island.

<sup>20</sup> 283 U.S. 465, 51 Sup. Ct. 499.

<sup>21</sup> 283 U.S. at 471, 51 Sup. Ct. at 501. It would seem that since a state clearly could regulate the rates charged by East Ohio to consumers, it certainly should be able to tax the sales. Therefore, it is difficult to see why the Court found it necessary to allude to the reduction of pressure in upholding the tax here. Cf. 58 HARV. L. REV. 1072 (1945).

<sup>22</sup> 284 U.S. 41, 52 Sup. Ct. 62 (1931).

attempted to exact its franchise tax from a pipeline company which transported gas into Mississippi and sold it at wholesale to distributing companies. In some instances delivery was made at reduced pressure for the accommodation of the distributors. In refusing to permit Mississippi to apply its tax to the pipeline company, the Court held that the sale and delivery to the distributors constituted interstate commerce. The reduction in pressure was characterized as incidental to the interstate sale and delivery, and an event not divesting the interstate transaction of its interstate nature.

The court returned to the mechanistic test to aid in the determination of a still later case, *Southern Natural Gas Corp. v. Alabama*.<sup>23</sup> In that case Alabama sought to apply a franchise tax based upon a foreign gas company's property lying within the state. The company was licensed to do business in Alabama, and maintained its principal office in that state, from which the entire management of the business was conducted. It purchased gas outside the state, piped it into Alabama, and there resold and delivered it to local distributing companies and to one industrial consumer. The company provided service pipes through which to conduct gas from its main pipelines onto the property of the industrial consumer, and, to accommodate the consumer, meters to reduce pressure at the point of delivery to the consumer. The Court held that the company was not engaged *solely* in interstate commerce, and therefore the privilege tax, not directly burdening interstate commerce, was valid. The Court stressed the providing of service lines and the reduction of pressure in concluding that the sale to the consumer was a local activity.

*Lone Star Gas Co. v. Texas*,<sup>24</sup> a regulation case decided immediately prior to the passage of the Natural Gas Act, by-passed the mechanistic test. A Texas company transported gas through pipelines which it operated in Texas and Oklahoma. It then sold this gas to affiliated distributing companies in Texas. The Texas commission attempted to regulate the price charged to the affiliated distributing companies for gas produced and delivered in Texas and also for gas produced and delivered in Texas and also for gas produced in Oklahoma and transported through the company's lines into Texas, on the ground that the property of the company comprised one integrated system. The Court upheld the Texas commission, declaring that the sale to the distributing companies of gas transported from Oklahoma was an essential part of the intrastate business of selling to consumers.

The decision in the *Lone Star* case is particularly disrupting to the theory of the majority opinion in the principal case that reduction of pres-

<sup>23</sup> 301 U.S. 148, 57 Sup. Ct. 696 (1937).

<sup>24</sup> 304 U.S. 224, 58 Sup. Ct. 883 (1938).

sure is the test distinguishing between federal and state power to regulate. The clear implication of the *Lone Star* case is that prior to the Natural Gas Act state regulatory power extended to the integrated facilities of a local distribution system even though some of these facilities lay beyond the state lines. In the principal case East Ohio's high pressure facilities were even more closely integrated into a local system than were those in the *Lone Star* case. Therefore, it would seem that under the *Lone Star* holding East Ohio's high pressure facilities would have been considered a proper subject for state regulation before the passage of the Natural Gas Act.

These decisions preceding the adoption of the Natural Gas Act manifest the Supreme Court's refusal to fix arbitrarily the limits of state regulatory power. Rather, the decisions appear to have been applications of the flexible rule that, until regulation of a field of interstate commerce has been pre-empted by Congress, transactions in that field which are essentially local in nature are proper subjects of state regulation. Thus, state regulatory power over companies engaged in the business of selling retail to consumers was always upheld; and, although state regulatory power over companies engaged in the business of selling wholesale to distributors for resale was generally denied, if the wholesale company and a retail company formed but units of a single corporate entity whose purpose was to sell gas to consumers, state power was acknowledged. In reaching this determination of whether the transaction sought to be regulated was sufficiently local in nature to admit of state regulation, resort was never had to the mechanistic test. Only in the solution of the problem of state tax power over a natural gas company was that test invoked, and even then not consistently.

Prior to the principal case, decisions of the Supreme Court construing the Natural Gas Act have failed to produce any consistent interpretation of the Act's jurisdictional clause. Certainly the cases have failed to consistently apply the mechanistic test. In *Illinois Natural Gas Co. v. Central Illinois Public Service Co.*,<sup>25</sup> the complainant, a wholly-owned subsidiary of an interstate gas company, owned pipelines solely within Illinois. It purchased gas transported into Illinois by the parent company at high pressure, reduced the pressure and sold the gas to Illinois distributing companies and industrial consumers. The Illinois commission ordered the complainant to extend its Illinois pipelines to connect with and supply gas to an additional distributing company. The Court held that the Illinois commission was without authority to issue the order, since the complainant was engaged in interstate commerce in the purchase and sale of gas moving

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<sup>25</sup> 314 U.S. 498, 62 Sup. Ct. 384 (1942).



in a continuous stream from outside the state into its pipes, and therefore came within the specific provision of the Natural Gas Act establishing federal regulation of sales for resale in interstate commerce.<sup>26</sup>

The majority in the principal case relied heavily on the *Illinois Natural Gas* case to establish that East Ohio's high pressure lines did not constitute facilities used in local distribution.<sup>27</sup> The Court reasoned that since the Illinois Natural Gas Co.'s lines lay wholly within one state, and yet were not considered to be facilities used in local distribution, East Ohio's likewise could not come within the local distribution exception. The Court, stating that the local distribution proviso of Section 1(b) ". . . cannot mean one thing for 'transportation' and another where 'sale for resale' is involved,"<sup>28</sup> considered immaterial the fact that the *Illinois Gas* case involved a company selling for resale, while the principal case involved a company selling direct to consumers. The Court's analysis would seem to be in error. In the *Illinois Gas* case the contention that the company's facilities were used in local distribution was not raised and was not passed upon by the Court. Therefore that case could be authority only for the view that East Ohio's high pressure lines were in interstate commerce, and not for the view that they were not facilities used for local distribution. More fundamentally, it seems probable that the phrase "local distribution" means sale to consumers, and that the exemption of local distribution from federal regulation could only apply to retail sales to consumers, and never operate as an exception to the federal regulation of sales for resale in interstate commerce. This construction of Section 1(b) is bolstered by the fact that in every natural gas case in which the term "local distribution" was employed, it was used to refer to transactions culminating in sales to consumers. If this construction is correct, the only issue which the Court in the *Illinois Gas* case could have decided was whether the sales by the company for resale were in interstate commerce, not whether they came within the "local distribution" exception.

The mechanistic test was once again invoked in *Colorado-Wyoming Gas Co. v. Federal Power Commission*.<sup>29</sup> In that case the complainant purchased gas in Colorado from an interstate pipeline company, and sold the gas in Colorado for resale to domestic consumers. In addition, it trans-

<sup>26</sup> In view of the Act's express reference to wholesale sales in interstate commerce, the Court declared that it did not have to decide whether the fact of pressure reduction was of any significance in determining state or federal power to regulate. It would seem, therefore, that the Court in that case, contrary to the majority opinion in the principal case, regarded the Natural Gas Act as supplanting rather than adopting prior decisions relating to the extent of regulatory power. It did not, however, deny that the power given to the FPC by Congress is only that power which states lack.

<sup>27</sup> 70 Sup. Ct. at 271.

<sup>28</sup> *Ibid.*

<sup>29</sup> 324 U.S. 626, 65 Sup. Ct. 850 (1945).

ported part of this gas to Wyoming and there sold it to an affiliated distributing company for resale. In finding that complainant's revenues were in excess of costs and a fair return, the FPC considered the costs incident to selling for resale in Colorado, on the ground that these sales for resale were subject to the Commission's jurisdiction. Complainant contended that these sales were in intrastate commerce and therefore not subject to FPC's jurisdiction. The Court, however, held that complainant's wholesale sales in Colorado were sales in interstate commerce for resale for ultimate public consumption, for the reason that the gas moved in a continuous stream across state lines to distributing companies in Colorado and Wyoming, and therefore the sales were subject to FPC regulation. The Court stated that this commerce did not end until the gas entered the service pipes of the distributing companies — that is, until pressure was reduced.<sup>30</sup> Here again the sales involved were wholesale sales, and again no contention was made that these sales constituted local distribution.

The Court refused to base its decision on the intensity of the pressure at which gas was transported in two other cases decided under the Natural Gas Act. In the first of these, *Interstate Natural Gas Co. v. Federal Power Commission*,<sup>31</sup> a producing company owning gas wells in Louisiana transported gas from the wells through Mississippi and back into Louisiana, where sales were made to three distributing companies and to industrial consumers. The producing company also sold and delivered gas at well pressure to pipeline companies, which then increased the pressure and transported the gas to other states for resale. The FPC attempted to regulate the price charged by the producing company to the Louisiana distributors and consumers and also the price charged to the pipeline companies. The producing company admitted FPC jurisdiction over the former sales, but contested jurisdiction over the latter sales. The Court sustained FPC's jurisdiction over the sales to the pipeline companies, stating that the gas was in interstate commerce before it reached the lines of the interstate pipeline companies because of the continuous interstate movement. The increase of pressure by the pipeline companies was regarded as "merely an incident in the interstate commerce rather than as its origin."<sup>32</sup> In support of its conclusion the Court cited *State Tax Commission v. Interstate Natural Gas Co.*<sup>33</sup> and the *Illinois Natural Gas* case.<sup>34</sup> Those cases, as shown above,

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<sup>30</sup> Complainant also sold gas direct to industrial consumers in Colorado. It was not stated whether the FPC asserted jurisdiction over these sales. However, it is extremely unlikely that it did, for complainant would certainly have raised the local distribution exception to contest FPC jurisdiction over those sales.

<sup>31</sup> 331 U.S. 682, 67 Sup. Ct. 1482 (1947).

<sup>32</sup> *Id.* at 689, 67 Sup. Ct. at 1486.

<sup>33</sup> Note 22 *supra*.

<sup>34</sup> Note 25 *supra*.

considered *reduction* of pressure to be immaterial in determining whether a state could tax or regulate wholesale sales to distributing companies. If the pressure at which gas is transported is not significant in determining state power over sales to pipeline companies or to distributing companies, it seems illogical to attribute significance to pressure in determining state power over sales to consumers.

In the second case in which the intensity of pressure was considered unimportant, *Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana*,<sup>35</sup> the Court expressly repudiated the mechanistic test. In that case a pipeline company transported gas from Texas into Indiana, reduced the pressure and sold the gas both to distributing companies and to industrial consumers. The Indiana commission ordered the pipeline company to file tariffs and annual reports as initial steps in a plan of regulation leading ultimately to possible regulation of rates and service in sales direct to consumers. The Court held that the transportation interstate and sale to consumers constituted interstate commerce, but since states before adoption of the Natural Gas Act had power to regulate sales direct to consumers, even though made by an interstate pipeline company, and since the Act was intended to complement rather than to supplant state power, the state commission had power to take necessary action looking to regulation of the sales. The Court expressly rejected the mechanistic test as a device for determining the existence of state regulatory power, suggesting instead that the nature of the state regulation, the objective of the state, and the effect of the regulation upon the national interest in the commerce regulated should all be considered in deciding whether state regulation should be upheld.<sup>36</sup> Since it seems clear that the broad intention of Congress was to preserve in state regulatory bodies control over transactions primarily of local interest, the subjective method by which the court in the *Panhandle Eastern* case determined the existence of state power to regulate seems more realistic than the mechanistic test used in the principal case. In *Connecticut Light & Power Co. v. Federal Power Commission*,<sup>37</sup> decided under

<sup>35</sup> 332 U.S. 507, 68 Sup. Ct. 190 (1947).

<sup>36</sup> If the rationale behind the *Panhandle Eastern* case had been applied by the Court in the principal case, the language of the Natural Gas Act would be more meaningful than it is now rendered. The *Panhandle Eastern* case would appear to repudiate the view that states may under the Act regulate only *intrastate* operations of a natural gas company. In the principal case the majority contends that states may regulate only after interstate commerce has ended, and that "interstate commerce" and "local distribution" are exclusive of each other. This contention renders the local distribution exception mere "surplusage." 70 Sup. Ct. at 270 n. 11. The wording of Section 1(b) would seem to indicate, however, that "local distribution" was intended to constitute a positive exception to the grant of jurisdiction, instead of a redundant explanation of the nature of the grant.

<sup>37</sup> 324 U.S. 515, 65 Sup. Ct. 749 (1945).

the Federal Power Act,<sup>38</sup> the Court employed such a subjective test to determine whether a distributor of electricity was subject to the jurisdiction of the FPC. The company operated wholly within the state of Connecticut. It received power from interstate lines at high voltage, stepped down the voltage and sold the power direct to consumers. The FPC, relying upon the *East Ohio Tax* case, found that the company was a "public utility" within the meaning of the Federal Power Act, because its high voltage lines were in interstate commerce, and therefore that the company was subject to the Commission's regulation. The Supreme Court, in reversing the Commission, held that although the company was engaged in the "transmission of electric energy in interstate commerce," the high voltage lines were "facilities used in local distribution"<sup>39</sup> and therefore exempt from federal regulation.

The decision in the principal case produces far-reaching economic and political results. One direct economic effect on the company and ultimately on the consumers will be the cost of complying with the requirement of the FPC to submit reports and records. Prior to this decision East Ohio had valued its property according to the theory of reproduction cost new.<sup>40</sup> The FPC requires that the reports submitted be based on the original cost theory of valuation.<sup>41</sup> In the hearing before the FPC the president of East

<sup>38</sup> 41 STAT. 1077 (1920), as amended, 49 STAT. 838 (1935), 16 U.S.C. § 792 *et seq.* (1940).

<sup>39</sup> *Id.* at 848, 16 U.S.C. § 824(b) (1940).

<sup>40</sup> OHIO GEN. CODE § 499-9 as construed makes it mandatory that the Ohio Public Utilities Commission base its determination of property valuations upon the reproduction cost new less depreciation. *East Ohio Gas Co. v. Public Utilities Commission of Ohio*, 133 Ohio St. 212, 12 N.E.2d 765 (1938). Rosenbaum, *Some Phases of Valuation by the Ohio Public Utilities Commission*, 6 U. OF CIN. L. REV. 22 (1932).

<sup>41</sup> Historically, the Supreme Court has favored the reproduction cost theory of valuation of property over the original cost method. Gradually, however, the Court decreased judicial review over commission findings until the FPC was released from the force of Supreme Court decisions requiring the use of reproduction cost. It has since used the basis of original cost. Welch, *Status of Regulatory Commissions Under the Hope Natural Gas Decision*, 32 GEO. L. J. 136 (1943). A survey of the accounting methods used by state commissions in FPC, STATE COMMISSION JURISDICTION AND REGULATION OF ELECTRIC AND GAS UTILITIES, PREPARED IN CO-OPERATION WITH NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS, 8 (1948) found that thirty-three state commissions fix rates and of these, seven base the determination on prudent investment, seven use fair value, seven use original cost, five consider all elements, one uses reproduction cost, and five use other methods. For a general appraisal of the accounting practices of the Federal Power Commission see Kohler, *Development of Accounting for Regulatory Purposes by the Federal Power Commission*, 14 GEO. WASH. L. REV. 152 (1945) (part of a special issue on the Federal Power Commission). For a thorough consideration of the efforts of the FPC to achieve uniformity among state accounting systems see BAUM, *THE FEDERAL POWER COMMISSION AND STATE UTILITY REGULATION* 135 *et seq.* (1942).

Ohio estimated the cost of compliance with this requirement to be between \$1,500,000 and \$2,000,000.<sup>42</sup> The estimate was not questioned on cross-examination and the FPC offered no evidence to refute it.<sup>43</sup> It did however report that experience with other companies indicated that the estimate was "considerably exaggerated."<sup>44</sup> But regardless of the amount of the financial burden, it is proper to inquire whether the possession of these reports by the FPC sufficiently assists effective natural gas regulation to justify the additional burden on the company and consumers. Since the FPC cannot regulate the rates charged by East Ohio to consumers,<sup>45</sup> the utility of these reports to the FPC is not readily apparent.<sup>46</sup>

Moreover, the decision in the principal case throws open the door to political conflicts between the states and the federal government.<sup>47</sup> One

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<sup>42</sup> Brief for the State of Ohio and The Public Utilities Commission of Ohio as Respondents, p. 39, *Federal Power Commission v. East Ohio Gas Co.*, 70 Sup. Ct. 266 (1950). "Since 'original cost' studies have to be made according to the FPC of all of East Ohio's property from the date it was first used to fulfill a public utility obligation it would require inspection and determination of property and accounts from 1846 to the present time." (citations omitted) *Ibid.*

<sup>43</sup> Brief for the State of Ohio and the Ohio Public Utilities Commission, *supra* note 42 at p. 39, *Federal Power Commission v. East Ohio Gas Co.*, 70 Sup. Ct. 266 (1950).

<sup>44</sup> *East Ohio Gas Co.*, 74 P.U.R. (N.S.) 256, 263 (1947).

<sup>45</sup> *Natural Gas Pipeline Co. of America v. Federal Power Commission*, 141 F.2d 27 (7th Cir. 1944).

<sup>46</sup> See Memorandum in Support of Petition for Rehearing Submitted on Behalf of the National Association of Railroad and Utilities Commissioners, and Certain State Regulatory Commissions as *Amicus Curiae*, p. 5, *Federal Power Commission v. East Ohio Gas Co.*, 70 Sup. Ct. 266 (1950); Brief for Respondents, *supra* note 42, p. 39. The only justification advanced by the FPC for imposing this additional accounting system upon East Ohio is that in order to maintain regulation on a national basis, it must have information available from a uniform system of accounts. Brief for Appellants, p. 80, *Federal Power Commission v. East Ohio Gas Co.*, 70 Sup. Ct. 266 (1950). This explanation perhaps supports the many observations that the FPC is expanding its jurisdiction to the fullest possible extent. See BAUM, *THE FEDERAL POWER COMMISSION AND STATE UTILITY REGULATION* 70 *et seq.* (1942); Alley, *What Makes the FPC Tick?*, 45 P.U. FORT. 142 (1950); Bricker, *The Significance of the East Ohio Gas Case*, 45 P.U. FORT. 201 (1950); Lippitt, *Is the Federal Power Commission Encroaching on Local Gas Regulation?*, 45 P.U. FORT. 13 (1950).

<sup>47</sup> It is pointed out in the majority opinion of the principal case that the Natural Gas Act did not purport to abolish all overlapping of jurisdiction. 70 Sup. Ct. at 272. For a discussion of the jurisdictional conflicts arising out of the principal case see Bricker, *The Significance of the East Ohio Gas Case*, 45 P.U. FORT. 201 (1950); Lippitt, *Is the FPC Encroaching on Local Gas Regulation?*, 45 P.U. FORT. 13 (1950). For a general survey of jurisdictional disputes with the state commissions see BAUM, *THE FEDERAL POWER COMMISSION AND STATE UTILITY REGULATION*, c. 2 (1942). The widespread effect of the principal case is illustrated by the fact that 43 cases presenting similar issues are now pending hearing before the Federal Power Commission. Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia, p. 19, *Federal Power Commission v. East Ohio Gas Co.*, 70 Sup. Ct. 266 (1950). Proceedings involving eight companies have

such conflict results from the power of the FPC to fix the rates of depreciation and amortization of East Ohio's property.<sup>48</sup> These rates when fixed by the FPC may be disregarded by the Ohio commission only for the purpose of determining the price to be charged for gas. Therefore, in approving or disapproving securities issued by East Ohio, the Ohio commission will be bound by depreciation rates set by the FPC.<sup>49</sup> Another conflict results from the possession by both the FPC and the Ohio commission of the power to determine the adequacy of gas reserves held or controlled by East Ohio.<sup>50</sup> Still another conflict may result from the fact that both commissions have authority to reallocate East Ohio's gas in times of emergency.<sup>51</sup>

The most obvious conflict is illustrated by the principal case itself. East Ohio must submit reports concerning its property to the FPC according to the FPC's original cost theory of valuation.<sup>52</sup> East Ohio must also submit similar reports to the Ohio commission, valuing its property on a reproduction cost basis.<sup>53</sup> There is no practical way to resolve this conflict unless the state commission abdicates its power to determine its own method of property valuation and adopts the method required by the FPC. The fundamental problem involved is not which system of accounting is preferable, but whether the states may freely choose the methods of regulation in those areas in which they have been held competent to act.<sup>54</sup> The extension of jurisdiction by the federal government serves only to embarrass and inhibit the effective regulation of the natural gas companies by the individual

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been formally docketed. These are: Central Natural Gas Corporation, Docket No. G-264; Iowa-Illinois Gas and Electric Co., Docket No. G-303; Michigan Consolidated Gas Co., Docket No. G-353; Consolidated Edison Company of New York, Docket No. G-1167; The Brooklyn Union Gas Co., Docket No. G-1171; Kings County Lighting Co., Docket No. G-1190; Eastern Indiana Gas Co., Docket No. G-1200; and Indiana Gas and Water Co., Docket No. G-1222. The three New York cases present an example of the extent to which the Federal Power Commission may be free to extend its control under the authority of the *East Ohio* case. Almost all of the facilities involved are entirely within New York City.

<sup>48</sup> Under § 9(a) of the Natural Gas Act, *supra* note 4, the FPC has authority to fix rates of depreciation and amortization for property of each "natural gas company." Ohio has delegated similar authority to the Ohio Public Utilities Commission by OHIO GEN. CODE §§ 614-49, -50. Section 9(a) further provides that state commissions may disregard these rates fixed by the FPC only for the purpose of determining rates or charges.

<sup>49</sup> OHIO GEN. CODE §§ 614-53, -54, -55. Brief for Respondents, *supra* note 42, p. 41.

<sup>50</sup> The Natural Gas Act § 14(b) conflicts with OHIO GEN. CODE § 614-8.

<sup>51</sup> The Natural Gas Act § 4(b) and OHIO GEN. CODE §§ 614-8, -15, -32. Brief for Respondents, *supra* note 42, p. 35.

<sup>52</sup> The Natural Gas Act § 8(a).

<sup>53</sup> OHIO GEN. CODE §§ 614-10, 499-10.

<sup>54</sup> See in the principal case the dissent, 70 Sup. Ct. 266, 279, discussing the opinion by Mr. Justice Brandeis in *New State Ice Co. v. Liebmann*, 285 U.S. 262, 52 Sup. Ct. 371 (1932).

states.<sup>55</sup> Because of the overlapping regulation resulting from the decision in the principal case, there is increased reason for the FPC and the Ohio commission to take full advantage of the opportunities under the Natural Gas Act for cooperation in the form of joint hearings and exchange of information.<sup>56</sup> However, in view of the apparent antagonism existing between the FPC and the state regulatory commissions, it is doubtful that full cooperation can be achieved. The best solution appears to lie in remedial legislation unequivocally restricting the regulation of local interests to the local commissions.<sup>57</sup>

JOHN H. GHERLEIN

<sup>55</sup> See Memorandum in Support of Petitions for Rehearing Submitted on Behalf of the Louisiana Public Service Commission as *Amicus Curiae*, p. 2, Federal Power Commission v. East Ohio Gas Co., 70 Sup. Ct. 266 (1950). Similar briefs were filed on behalf of the States of Georgia and Kansas. An important source of support was in such a brief filed by the National Association of Railroad and Utilities Commissioners, stating that it spoke on behalf of 36 state commissions and the commission for the District of Columbia, and declaring that the commissions were "... concerned over the sweeping effect of the majority decision in this cause, which expands Federal Power Commission jurisdiction to the extent of curtailing and rendering ineffective current state commission regulation. . . ."

<sup>56</sup> BAUM, THE FEDERAL POWER COMMISSION AND STATE UTILITY REGULATION, c. VII (1942). At page 272 Baum states, "Based on the foregoing over-all picture, the writer concludes that the Federal Power Commission throughout its history has developed and followed with remarkable degree of success an extensive procedure of collaboration with the states." A contrary view is set forth in Foster, *The Federal Power Commission and State Jurisdiction*, Series 4, No. 1 CONTEMPORARY LAW PAMPHLETS (1940).

<sup>57</sup> There is now pending before the Senate Committee on Interstate and Foreign Commerce a bill which alters the definition, under the Natural Gas Act, of the term "natural gas company." S. 1831, 81st Cong., 1st Sess. (1949). This bill provides:

"... [T]he term 'natural-gas company' does not include any person engaged in local distribution within a State who receives natural gas within or at the border of such State into local distribution facilities as herein defined and sells and delivers such gas (i) to the general public for ultimate consumption therein, or (ii) to another person engaged in local distribution within the same State who sells and delivers such gas to the general public for ultimate consumption therein, such sales and persons being hereby declared subject to regulation by the several States." This proposed amendment defines "local distribution facilities" to include high pressure mains such as those used by East Ohio. H.R. 4028, 81st Cong., 1st Sess. (1949) is an identical bill pending in the House of Representatives. A more recent bill to the same effect is S. 2964, 81st Cong., 2d Sess. (1950).